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SIPDIS

SENSITIVE

DEPT FOR AF/E, AF/EPS

DEPT PASS USTR

DEPT PASS DEPT OF LABOR ATTN ILAB FOR KELLY BRYANT

USAID FOR AFR/EA JULIA ESCALONA

TREASURY FOR ANN ALIKONIS

LONDON AND PARIS FOR AFRICA WATCHERS

E.O. 12958: N/A

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SUBJECT: Export Processing Zone Faces Competitive Pressures

REF: Nairobi 4238

Sensitive But Unclassified. Not for release outside USG channels.

**¶1. (SBU)** Summary: Kenya's Export Processing Zones (EPZ) face rising wage and energy costs, poor transportation infrastructure, and constraining government regulations that make it difficult to attract investors and compete with Asian exporters. Nevertheless, the EPZ Authority (EPZA) believes it could compete effectively to attract and retain investors if only the Government of Kenya would follow up on its own promises and actively address these constraints. EPZ exports rose 67% in 2004 to \$311.5 million, 92% of them to the U.S. under the AGOA and GSP programs. But seven garment plants have shut down since the end of the Multi-Fiber Agreement (MFA) at the start of 2005. The EPZA credits AGOA with its success to date, but is trying to diversify its investor base beyond textiles and garments. End summary.

**¶2. (U)** On October 18, Econoff visited the Athi River Export Processing Zone, the largest of Kenya's 41 EPZs, together with the Econ FSN and Sarah Abwoja of the Kenyan Textile Workers Union to view investment and working conditions. EPZA officials briefed on the status and prospects of the EPZs, and arranged tours of a pharmaceuticals and a textile plant.

**¶3. (U)** EPZA Public Relations Manager Jonathan Chifallu explained that the Authority provides a one-stop shop to help investors set up factories, facilitating and advising on all permits, clearances, utility hookups, financing, labor laws, etc. Although some GOK officials were initially wary of the costs of offering foreign investors tax and other incentives when the EPZs were established in 1990, the GOK now sees the Zones' potential to create jobs, exports and growth. In fact, Chifallu claimed that the EPZA now advises GOK officials on how to make Kenya's laws more investor-friendly. Chifallu noted the Athi River EPZ has become a magnet for urban and industrial development in a previously barren area south of Nairobi.

**¶4. (SBU)** Garment factories represent the large majority of EPZ exports and workers. Although orders recovered somewhat after the post-MFA dip, Chifallu said textile prices had dropped to compete with China. Although seven garment plants in Kenyan EPZs have closed down since the end of the MFA on January 1, 2005, he thought Kenya's EPZ garment factories could remain competitive, if the GOK acted to reduce bureaucratic requirements and improved Kenya's infrastructure. EPZ exports in 2004 of \$311.5 million represented 11.6% of Kenya's global exports. 94% of EPZ exports in 2004 went to the U.S., and the AGOA/GSP exports of \$222 million represented 81% of Kenya's total exports to the U.S. Chifallu said the EPZA is working to diversify by attracting investors from other sectors.

**¶5. (SBU)** Chifallu noted that one of the key requirements for global competitiveness is to maximize efficiency in the logistical chain. He explained how GOK agencies' erratic demands for inspections and certifications from which investors should be exempt under the EPZ Act raise production costs. He cited the sudden requirement that duties on oil be paid up-front and the Kenya Revenue Authority's (KRA) poor implementation of the electronic clearance system, which created critical shortages of imported inputs and made it difficult to meet buyers' deadlines. KRA only recently stopped its two-year requirement for verification of the contents of all containers of inputs destined for the EPZ. The EPZA would like the Kenya Port Authority to waive ship demurrage charges for importers when delays are caused by the GOK. Electricity is the most expensive input for EPZ investors, who want the GOK and the Kenya Electricity Generating Company (KenGen) to provide some relief from one of the highest prices per kWh in Africa. Investors at Athi River

are even considering building their own power plant.

16. (SBU) Industrial Relations Executive Wanjiru Waweru explained that the EPZA advises investors on Kenya's labor laws and helps them deal with the Ministry of Labor and Human Resource Development, the National Social Security Fund, and other agencies. She claimed that the previous perception by the Ministry of Labor, unions and others that unions were barred in the EPZs was never correct, and was a misinterpretation of the EPZ Act. (Comment: This claim seems disingenuous at best. End comment.) The misperception was corrected after the 2002 election. However, the collective bargaining agreement (CBA) signed by the union and seven garment plants in Athi River in 2003 is the only one in a Kenyan EPZ. Only one other EPZ plant in Mombasa has recognized the union, and CBA negotiations there have been stalled since January. The CBA significantly increased salaries and reduced sexual harassment complaints in the Athi River plants, but has made it more difficult to compete with garment factories in China, India and Sri Lanka, which pay lower wages. Waweru called for the textile union to recognize these pressures and educate its members on the importance of productivity and quality, as well as their rights. Waweru praised a recent initiative by shop stewards to go to Mombasa and urge KRA officials at the port to release containers of inputs.

17. (SBU) Chifallu claimed that the wage increases the GOK has mandated every May Day for the last four years have amounted to a cumulative 50% increase, contributing to Kenya's high production costs. He urged that the GOK find ways to reduce costs for both producers and workers, such as encouraging low-cost housing to avoid the rent increases landlords implemented after each wage increase. He wondered why NGOs and others focused complaints about low wages solely on the EPZ producers, when the GOK's own salaries for the lowest grades of civil service workers were below the minimum wage until a recent increase.

18. (SBU) Comment: The EPZA appears to understand clearly the need to improve Kenya's competitiveness to attract and retain investors, while trying to respect worker rights. Chifallu believes senior GOK officials understand the need to cut production costs and improve the investment environment, but his despair about the likely lack of any effective actions until after the November 21 referendum on the proposed new Constitution is well-warranted (see reftel.) Further, it is open to question whether the GOK will focus better on needed economic reforms, even after the referendum. End Comment.

19. (U) The EPZ 2004 annual report and other information is available on the EPZA website, [www.epzakenya.com](http://www.epzakenya.com). The following are relevant statistics culled from the reports. All 2003-04 figures below are in millions of Kenyan shillings unless otherwise indicated.

Indicator	2003	2004
EPZ Exports .....	13,812 .....	23,047
Kenyan Exports .....	174,900 .....	198,400
EPZ Share of total		
Kenyan exports .....	7.9% .....	11.6%
AGOA textile exports (\$millions) .....	\$146 .....	\$222
change .....	+40.4% .....	+52.1%
AGOA share of total		
Kenya-US exports .....	74% .....	81%
Investment .....	16,716 .....	17,012
Kenyan employees .....	38,199 .....	37,723
Average annual Kenyan wage (ksh) .....	62,799 .....	86,379

Bellamy